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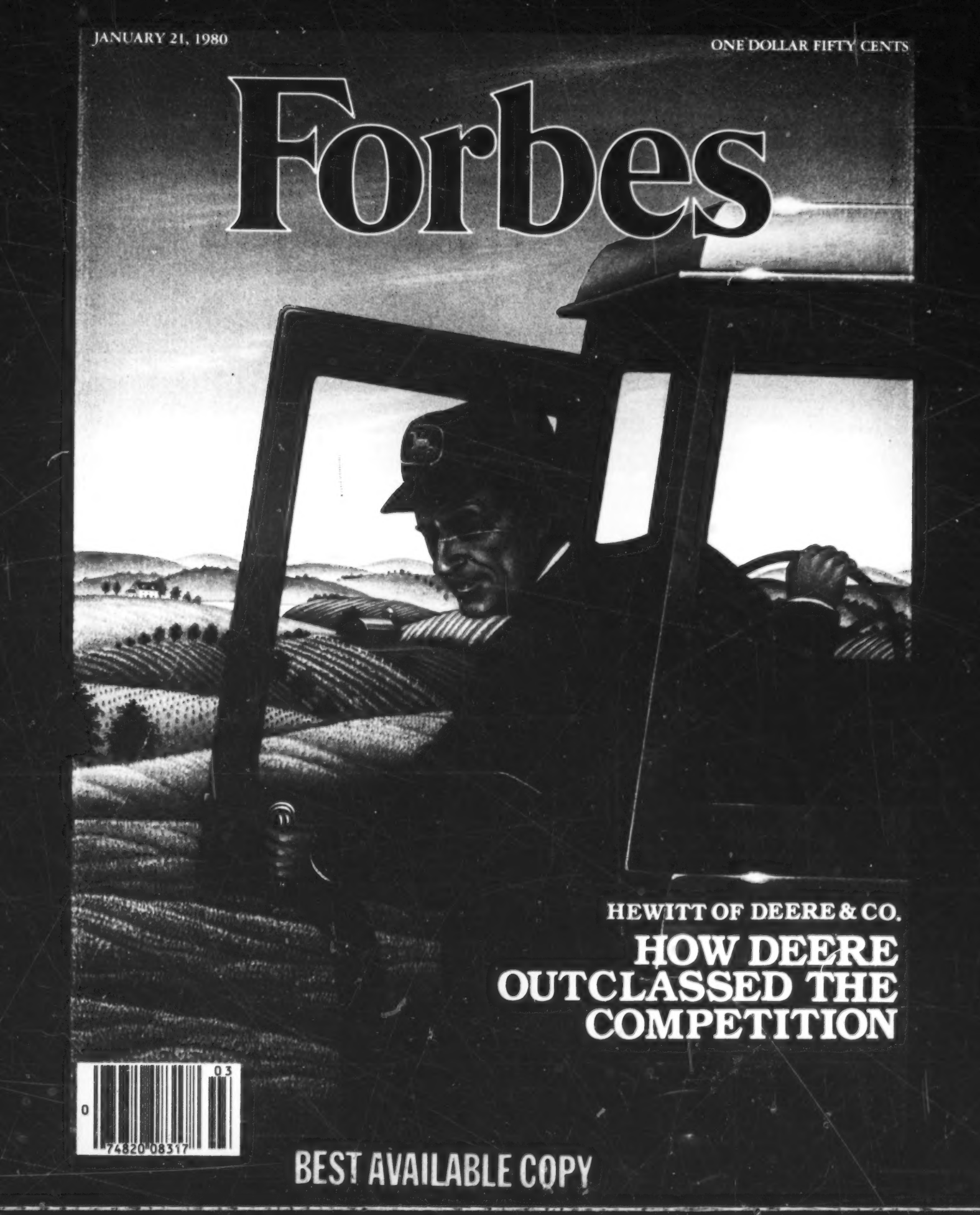

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## HOW DEERE OUTCLASSED THE COMPETITION

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Forbes

January 21, 1980
Volume 125, Number 2

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**Photos:** pp. 8, 82 bottom, Patrick Pagnano; p. 9, Bettmann Archive; pp. 12, 21, UPI; p. 23, Dennis Brack/Black Star; p. 32, Ricardo Thomas; p. 34, Sygma; pp. 41 top, 42 top, 43 top, Art Shay; p. 46, James Caccavo/Empire; p. 50, John Grossman; pp. 55, 56, 61, 65, 78, Bill Kelly; pp. 57, 58, Ray Fisher; p. 71, Shelley Katz; p. 81, Steve Murray; p. 82 top, John Chang McCurdy; p. 84 left, Peter Tatiner/Gamma Liaison; p. 86 left & right, Leroy Woodson Jr. **Drawings:** p. 31, Steven Bodner. **Charts:** pp. 33, 89, Andrew Christie.
**Cover Illustration:** Mark Hess **Design Consultant:** Peter Palazzo

Forbes (ISSN 0015 6914) is published biweekly by Forbes Inc., 60 Fifth Ave., New York, N.Y. 10011. Second-class postage paid at New York, N.Y. and at additional mailing offices. Subscription $24 a year, U.S.A. Postmaster: Send address changes to Forbes, 60 Fifth Ave., New York, N.Y. 10011. Copyright © 1980 Forbes Inc.

*The natural gas industry is well along on the way to decontrol. But will it ever get there?*

# Will the free market get a chance?

By Howard Rudnitsky with Alyssa A. Lappen

THE NATION HAS ALREADY had a foretaste of what's in store if it heeds the calls from legislators for more government regulation of the oil industry. And a bitter foretaste it is.

A quarter of a century ago, the Federal Power Commission slapped price controls on interstate gas. That left the wellhead price at the time at 10 cents per 1,000 cubic feet. It also kept supply down. Understandably, few producers would spend lots of money to find more natural gas when—more than a decade later—they could only hope to sell it for 16 cents. By the mid-Seventies gas was in short supply, utilities were refusing to accept new customers and many natural-gas-burning industries had to shut down during the winter of 1976-77 so that homeowners wouldn't shiver.

While total energy use in the U.S. grew by 5% between 1972 and 1978, natural gas consumption fell by 15%—the only major fuel to decline. Production fell from a peak of 22.6 trillion cubic feet in 1972 to 19.3 trillion in 1978. Reserves plummeted by 90 trillion cubic feet, or 31%, in the Seventies alone. The result has been that we now are forced to buy gas from countries like Canada at more than $3 per 1,000 cubic feet.

By late 1978 the mess was so obvious that Congress passed the landmark Natural Gas Policy Act, which did away with the two-tier price structure and allowed natural gas prices to rise gradually through 1985, after which controls would be completely lifted.

The result will be a revival for gas producers and utilities that seems likely to extend into the middle of the decade, even if the oil industry, currently America's favorite scapegoat, seems destined to wind up under some kind of utility-type regulation.

The signs of the gas revival are abundant: About a quarter of a million residential users converted from oil to gas in 1979, according to the American Gas Association—an increase of 57% over 1978 that overcame a 14% drop in new housing starts last year and pushed total residential gas usage up slightly. Industrial use rose by more than 14%. Earnings of interstate pipelines grew by 10% to 12% and those of distribution companies increased by 4% to 5%.

*Converting oil furnace to gas*
**Now, some reason to believe.**

First Boston's natural gas analyst, R. Gamble Baldwin, believes the wholesale end of the business—natural gas transmission companies—will have overall earnings growth over the next five years of close to 10% a year. The more politically sensitive retailers—gas distribution utilities—will probably grow only about half that fast.

The market acknowledged this last year with a 35% increase in the prices of gas utility shares. Analysts like Baldwin believe the runup is not over. Says Baldwin: "There may be a mild down cycle in 1980. But you can look across that gap and see the government putting increased emphasis on gas to offset oil imports. Over the long term these stocks are going to be good."

For the next few years, gas is one of the few bright spots in the energy situation. Coal has been slow to develop, nuclear energy virtually stopped and the U.S. oil supply hangs by an OPEC thread. The U.S. has been thoroughly explored at relatively shallow levels, but at current prices it pays to delve deeper into the earth—below 15,000 feet, that is. At those depths, there is much more likely to be gas than oil. The prospects of finding large additional reservoirs of oil in the U.S. are fairly slim, but the chances for gas are excellent.

The U.S. already produces about 90% of the gas it uses. That's about 25% of its total energy usage. Proven U.S. gas reserves (excluding Alaska) total about 174 trillion cubic feet—about nine years' supply—while another 200 trillion cubic feet or so lies in unproven but known reserves, about a fifth of it below that 15,000-foot level, where serious drilling has just begun. While the decade-long decline in proven gas reserves continues, the last two years' additions to reserves were the largest since the late Sixties. Some companies, moreover, did spectacularly well in drilling. Houston Natural Gas, for example, which handles over 4% of the country's volume, found twice as much as it sold. Texas Gas Transmission Corp. brought in new finds in the Gulf of Mexico and boosted production from 33 billion cubic feet in 1978 to 42 billion. One of the most aggressive pipeline companies, Houston's Transco Cos., has poured over $790 million into finding some 372 billion cubic feet of new reserves during the Seventies. Transco spent $250 million in 1979 alone, more than four times 1979 earnings.

Has the lesson that the market is a better provider than the government been learned? Not really. Voices are loud in the land for increased regulation, even nationalization, of the oil industry. Even in natural gas, the victory of the free market forces isn't complete.

Drop back to 1954, the year price controls were put on natural gas. From that time on the fuel was so cheap in interstate pipelines that whole industries and many electrical utilities switched to natural gas. When the shortages came in the mid-Seventies, states like Ohio ran out of gas. So in the 1978 deregulation bill, Congress declared its intent that homeowners be given first crack at clean-burning, efficient natural gas. The bill set an incremental pricing policy that, in effect, makes the big industrial users pay a higher price than the small individual users.

That seems reasonable, but it could have unforeseen results. For one thing, this residential preference could penalize gas companies that are heavy on industrial customers and relatively light on home residential customers—for example, Oklahoma Natural Gas, American Natural, Northwest Energy, Houston Natural Gas or Columbia Natural Gas.

But even when there is a balance between industrial or utility customers on the one hand and residential users on the

## Gas utility stocks—is the rise over?

**Gas utility stocks in 1979 reflected brightening prospects—a few doubled in price. Best performers: intrastate integrated companies, followed closely by the interstate integrated group. Distributors provided 9% to 10% yields.**

**Is the rise over? In the short run perhaps. But many analysts figure the long-run outlook is still good, particularly because undervalued gas and even oil reserves of many gas companies are expected to grow significantly.**

| Company (12-month revenues, $ mil) | 5-year growth rate revenues | 5-year growth rate EPS | Return on equity | Book value | Recent price | 52-week price range | Latest 12 months EPS | Price/ earnings ratio | Indicated dividend yield |
|---|---|---|---|---|---|---|---|---|---|
| **Intrastate** | | | | | | | | | |
| **Integrated and Pipelines** | | | | | | | | | |
| ENSERCH (2,035) | 34.7% | –9.5% | 14.3% | $17.62 | 29¼ | 30⅝-17 | $2.51 | 12 | 5.3% |
| Houston Natural Gas (1,798) | 21.7 | 15.4 | 22.0 | 16.25 | 40½ | 42 -21⅜ | 3.57 | 11 | 2.7 |
| NICOR (1,469) | 25.4 | 12.9 | 16.4 | 29.49 | 31⅞ | 35⅛-26⅜ | 4.84 | 7 | 7.9 |
| Oklahoma Natural Gas (676) | 27.6 | 12.3 | 16.1 | 19.21 | 24⅜ | 26⅛-18 | 3.10 | 8 | 7.4 |
| Pacific Lighting (1,979) | 18.5 | 10.3 | 14.3 | 27.03 | 22⅛ | 23⅞-19⅜ | 3.87 | 6 | 10.1 |
| Pioneer (660) | 24.5 | 14.3 | 30.8 | 9.46 | 34⅛ | 35⅞-12⅛ | 2.91 | 12 | 3.4 |
| Texas Oil & Gas (900) | 37.8 | 24.7 | 27.0 | 16.65 | 59⅝ | 65⅛-32 | 4.50 | 13 | 0.8 |
| **Interstate** | | | | | | | | | |
| **Integrated** | | | | | | | | | |
| American Natural Resources (2,337) | 23.5 | 4.2 | 10.3 | 42.35 | 47⅛ | 48⅛-36 | 4.35 | 11 | 6.7 |
| Arkansas Louisiana (664) | 17.5 | 2.7 | 18.2 | 26.87 | 27½ | 28¼-15¼ | 2.44 | 11 | 4.5 |
| Columbia Gas (2,643) | 17.7 | 4.3 | 13.1 | 32.25 | 38 | 40⅛-25⅛ | 4.23 | 9 | 6.4 |
| Consolidated Natural Gas (1,851) | 16.5 | 14.6 | 12.4 | 45.80 | 41⅝ | 45 -36 | 5.68 | 7 | 7.8 |
| Entex (719) | 49.5 | 36.6 | 26.5 | 8.22 | 17⅜ | 19⅛-11¼ | 1.99 | 9 | 4.6 |
| Peoples Gas (2,442) | 27.1 | 7.4 | 15.2 | 34.88 | 43⅜ | 44 -31⅝ | 5.29 | 8 | 6.9 |
| **Pipelines** | | | | | | | | | |
| El Paso Co (2,769) | 12.9 | –19.0 | 20.8 | 15.52 | 20⅜ | 23⅛-15 | 3.23 | 6 | 7.1 |
| Northern Natural Gas (2,262) | 17.3 | 3.7 | 18.2 | 41.55 | 56 | 57 -33⅜ | 7.58 | 7 | 5.4 |
| Panhandle Eastern (1,829) | 25.5 | 10.0 | 21.1 | 42.27 | 61 | 66 -37⅞ | 8.91 | 7 | 5.1 |
| Southern Natural Resources (1,367) | 19.1 | 15.3 | 17.1 | 30.86 | 54⅞ | 55⅛-31½ | 5.27 | 10 | 2.7 |
| Tenneco (10,446) | 15.0 | 2.6 | 16.5 | 31.31 | 38 | 41½-29 | 5.16 | 7 | 6.3 |
| Texas Eastern (2,649) | 17.5 | 10.3 | 19.1 | 34.38 | 67¼ | 69¼-33⅜ | 6.58 | 10 | 4.0 |
| Texas Gas Transmission (1,532) | 15.2 | 6.1 | 15.8 | 21.30 | 26⅛ | 29 -17⅜ | 3.37 | 8 | 5.5 |
| Transco Companies (1,367) | 17.0 | 47.5 | 14.0 | 18.31 | 43⅛ | 44⅞-19 | 2.57 | 17 | 2.9 |
| United Energy Resources (2,692) | 34.5 | 59.0 | 26.5 | 31.53 | 64 | 67⅝-32½ | 8.34 | 8 | 3.9 |
| **Distributors** | | | | | | | | | |
| Atlanta Gas Light (547) | 20.5 | 0.6 | 10.4 | 25.18 | 14⅜ | 17⅛-13⅜ | 2.61 | 6 | 10.0 |
| Brooklyn Union Gas (466) | 14.9 | 9.8 | 14.5 | 23.47 | 22½ | 25 -18⅜ | 3.40 | 7 | 9.9 |
| Gas Service (405) | 18.1 | 9.3 | 14.1 | 18.20 | 15 | 16¼-12¼ | 2.56 | 6 | 8.5 |
| Laclede Gas (390) | 17.7 | 7.8 | 15.0 | 24.96 | 19½ | 23⅜-18 | 3.75 | 5 | 9.5 |
| National Fuel Gas (617) | 15.0 | 8.7 | 11.7 | 38.67 | 28⅛ | 31 -25⅛ | 4.51 | 6 | 8.9 |
| Washington Gas Light (345) | 16.3 | –2.0 | 5.0 | 31.72 | 22⅛ | 27½-21⅜ | 1.59 | 14 | 10.8 |
| Wisconsin Gas (360) | 19.0 | 7.4 | 14.0 | 25.71 | 21¼ | 25⅛-19⅛ | 3.60 | 6 | 9.4 |

other, there still can be problems. Houston Natural's CEO, Robert R. Herring, puts it this way: "We're under pressure from Washington right now to supply just as much gas as we can to reduce oil imports—while at the same time the deregulation act says that by 1990 we can't be supplying gas to any major boiler [*i.e.*, industrial user]. We're probably selling 25% of all the gas sold in the country to that boiler market now. Without those customers, we're going to be a much more seasonal market."

Seasonality is the curse of any utility; it means idle capacity. Says Herring: "You also wind up varying the take of a well and in many cases you damage it by pulling hard one day and not the next. There are other problems. Take our Gomez Field in West Texas. You've got at least two pipelines that stay inside the state and three that go out. We have to take on an equitable basis from our producer leases. Now as you take equitably from one field, you may have to take even more from him [the other customer] in order to be equitable in your take in these various joint-type fields. It can become incredibly complicated."

Obviously, when a government intervenes in the marketplace, even in a limited way, that interference can have unforeseeable consequences. A modern society can't really go to laissez-faire, but it is certainly an argument for holding regulation to a carefully thought out minimum.

Deregulation in natural gas, moreover, has yet to meet what may be its toughest political test. As deregulation proceeds, prices are going to rise. That is not going to sit well with residential gas users, particularly those who recently converted from other fuels. They will complain, and rate commissions will listen. In 1979, for example, local rate commissions gave Michigan Consolidated, a distribution subsidiary of American Natural Resources, a hard time on rate increases and the subsidiary barely broke even in 1979. In short, the commission forced the distributor to swallow the higher cost of service and maintenance. Mountain Fuel Supply, an intrastate gas utility, too, was squeezed for two years by a stingy Utah Public Service Commission and its earnings took a nose dive. The commission, which had held off granting badly needed rate increases, finally eased up somewhat toward the end of the year.

But, in the same state, governmental control is now rearing its head again. Last May the Utah Supreme Court ruled that Mountain Fuel, which drills for gas out of state, must include its Wexpro oil and gas exploration subsidiary in the overall parent operation, thus putting it under the control of the Utah Public Service Commission. The company has appealed to the U.S. Supreme Court.

In view of all this, chances grow that the heavy hand of government will be felt again by the middle of the decade. According to James L. Ketelsen, chairman of Tenneco Inc., if gas prices continue to rise, "what we could find by 1985 is that people will be unwilling to allow deregulation of new gas."

Again and again the market has proven itself to be the most efficient allocator of resources. Yet the temptation to intervene in the marketplace seems irresistible. People who would go to the barricades to safeguard the snail darter's place in the physical environment seem blind to the ecological role of profit in the equally complex and equally interdependent economic environment. ■